### Allowable Costs – State/Local Government-wide Central Service Costs

Most governmental entities provide services, such as accounting, purchasing, computer services, and fringe benefits, to operating agencies on a centralized basis. Since the Federal awards are performed within the individual operating agencies, there must be a process whereby these central service costs are identified and assigned to benefiting operating agency activities on a reasonable and consistent basis. The State/local government-wide central service cost allocation plan (CAP) provides that process. (Refer to 2 CFR Part 200, Appendix V, for additional information and specific requirements.)

The allowable costs of central services that a governmental unit provides to its agencies may be allocated or billed to the user agencies. The State/local government-wide central service CAP is the required documentation of the methods used by the governmental unit to identify and accumulate these costs, and to allocate them or develop billing rates based on them.

Allocated central service costs (referred to as Section I costs) are allocated to benefiting operating agencies on some reasonable basis. These costs are usually negotiated and approved for a future year on a “fixed-with-carry-forward” basis. Examples of such services might include general accounting, personnel administration, and purchasing. Section I costs assigned to an operating agency through the State/local government-wide central service CAP are typically included in the agency’s indirect cost pool.

Billed central service costs (referred to as Section II costs) are billed to benefiting agencies and/or programs on an individual fee-for-service or similar basis. The billed rates are usually based on the estimated costs for providing the services. An adjustment will be made at least annually for the difference between the revenue generated by each billed service and the actual allowable costs. Examples of such billed services include computer services, transportation services, self- insurance, and fringe benefits. Section II costs billed to an operating agency may be charged as direct costs to the agency’s Federal awards or included in its indirect cost pool.

**Compliance Requirements – State/Local Government-Wide Central Service Costs**

1. *Submission Requirements*
   1. Submission requirements are identified in 2 CFR Part 200, Appendix V, paragraph D.
   2. A State is required to submit a State-wide central service CAP to HHS for each year in which it claims central service costs under Federal awards.
   3. A “major local government” is required to submit a central service CAP to its cognizant agency for indirect costs annually. *Major local government* means a local government that receives more than $100 million in direct Federal awards (not including pass-through awards) subject to 2 CFR Part 200, Subpart E. All other local governments claiming central service costs must develop a CAP in accordance with the requirements described in 2 CFR part 200 and maintain the plan and related supporting documentation for audit. These local governments are not required to submit the plan for Federal approval unless they are specifically requested to do so by the cognizant agency for indirect costs.
   4. All central service CAPs will be prepared and, when required, submitted within the 6 months prior to the beginning of the governmental unit’s fiscal years in which it proposes to claim central service costs. Extensions may be granted by the cognizant agency for indirect costs on a case-by-case basis.
2. *Documentation Requirements*
   1. The central service CAP must include all central service costs that will be claimed (either as an allocated or a billed cost) under Federal awards. Costs of central services omitted from the CAP will not be reimbursed.
   2. The documentation requirements for all central service CAPs are contained in 2 CFR Part 200, Appendix V, paragraph E. All plans and related documentation used as a basis for claiming costs under Federal awards must be retained for audit in accordance with the record retention requirements contained in 2 CFR section 200.334(f).
3. *Required Certification –* No proposal to establish a central service CAP, whether submitted to the cognizant agency for indirect costs or maintained on file by the governmental unit, must be accepted and approved unless such costs have been certified by the governmental unit using the Certificate of Cost Allocation Plan as set forth in 2 CFR Part 200, Appendix V, paragraph E.4.
4. *Allocated Central Service Costs (Section I Costs)* – A carry-forward adjustment is not permitted for a central service activity that was not included in the approved plan, or for unallowable costs that must be reimbursed immediately (2 CFR Part 200, Appendix V, paragraph G.3).
5. *Billed Central Service Costs (Section II Costs)*
   1. Each billed central service activity must separately account for all revenues (including imputed revenues) generated by the service, expenses incurred to furnish the service, and profit/loss (2 CFR Part 200, Appendix V, paragraph G.1).
   2. Internal service funds for central service activities are allowed a working capital reserve of up to 60 calendar days cash expenses for normal operating purposes (2 CFR Part 200, Appendix V, paragraph G.2). A working capital reserve exceeding 60 calendar days may be approved by the cognizant agency for indirect costs in exceptional cases.
   3. Adjustments of billed central services are required when there is a difference between the revenue generated by each billed service and the actual allowable costs (2 CFR Part 200, Appendix V, paragraph G.4). A comparison of the revenue generated by each billed service (including total revenues whether or not billed or collected) to the actual allowable costs of the service will be made at least annually, and an adjustment will be made for the difference between the revenue and the allowable costs. The adjustments will be made through one of the following methods, at the option of the cognizant agency:
      1. If revenue exceeds costs, a cash refund to the Federal Government for the Federal share of the adjustment, including earned or imputed interest from the date of expenditure and debt interest, if applicable, chargeable in accordance with applicable cognizant agency for indirect costs regulations;
      2. Credits to the amounts charged to the individual programs;
      3. Adjustments to future billing rates; or
      4. Adjustments to allocated central service costs (Section I) if the total amount of the adjustment for a particular service (Federal share and non-Federal share) does not exceed $500,000.
   4. Whenever funds are transferred from a self-insurance reserve to other accounts (e.g., general fund), refunds must be made to the Federal Government for its share of funds transferred, including earned or imputed interest from the date of transfer and debt interest, if applicable, chargeable in accordance with applicable cognizant agency for indirect cost claims collection regulations (2 CFR section 200.447(d)(5)).

*(Source: 2023 OMB Compliance Supplement Part 3)*

#### Audit Objectives and Control Testing - Allowable Costs - State/Local Government-wide Central Service Costs

**Audit Objectives**

1. Obtain an understanding of internal control, assess risk, and test internal control as required by 2 CFR section 200.514(c).
2. Determine whether the governmental unit complied with the provisions of 2 CFR part 200 as follows:
   1. Charges to cost pools allocated to Federal awards through the central service CAPs were for allowable costs.
   2. The methods of allocating the costs are in accordance with the cost principles, and produce an equitable and consistent distribution of costs, which benefit from the central service costs being allocated (e.g., cost allocation bases include all activities, including all State departments and agencies and, if appropriate, non-State organizations which receive services).
3. Cost allocations were in accordance with central service CAPs approved by the cognizant agency for indirect costs or, in cases where such plans are not subject to approval, in accordance with the plan on file.

*(Source: 2023 OMB Compliance Supplement Part 3)*

**Control Documentation and Testing**

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| *Auditors should clearly document what control procedures address the compliance requirement. Reference or link to documentation or where testing was performed.*  **Basis for the control** *(Ex. reports, resources, etc. providing information needed to understand requirements and prevent or identify and correct errors)*:  **Control Procedure** *(Description of how auditee uses the “Basis” to prevent, or identify and correct or detect errors)*:  **Person(s) responsible for performing the control procedure** *(Title)*:  **Description of evidence documenting the control was applied** *(i.e. sampling unit)*: |

#### Suggested Substantive Audit Procedures – Compliance – State/Local Government-Wide Central Service Costs

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| Consider the results of control testing above in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance.  *(Source: 2023 OMB Compliance Supplement Part 3)*  a. For local governments that are not required to submit the central service CAP and related supporting documentation, the auditor should consider the risk of the reduced level of oversight in designing the nature, timing and extent of compliance testing.  b. *General Audit Procedures for State/Local Government-Wide Central Service CAPs* – The following procedures apply to charges to cost pools that are allocated wholly or partially to Federal awards or used in formulating indirect cost rates used for recovering indirect costs under Federal awards.  (1) Test a sample of transactions for conformance with:  (a) The criteria contained in the “Basic Considerations” section of 2 CFR Part 200, Subpart E (200.402 – 200.411).  (b) The principles to establish allowability or unallowability of certain items of cost (2 CFR 200.420 – 200.476).  (2) If the auditor identifies unallowable costs, the auditor should be aware that directly associated costs might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost, and would have not been incurred if the other cost had not been incurred. When an unallowable cost is incurred, directly associated costs are also unallowable. For example, occupancy costs related to unallowable general costs of government are also unallowable.  c. *Special Audit Procedures for State/Local Government-Wide Central Service CAPs*  (1) Verify that the central service CAP includes the required documentation in accordance with 2 CFR Part 200 Appendix V, paragraph E.  (2) *Testing of the State/Local Government-Wide Central Service CAPs – Allocated Section I Costs*  (a) If new allocated central service costs were added, review the justification for including the item as Section I costs to ascertain if the costs are allowable (e.g., if costs benefit Federal awards).  (b) Identify the central service costs that incurred a significant increase in actual costs from the prior year’s costs. Test a sample of transactions to verify the allowability of the costs.  (c) Ascertain if the bases used to allocate costs are appropriate, i.e., costs are allocated in accordance with relative benefits received.  (d) Ascertain if the proposed bases include all activities that benefit from the central service costs being allocated, including all users that receive the services. For example, the State-wide central service CAP should allocate costs to all benefiting State departments and agencies, and, where appropriate, non-State organizations, such as local government agencies.  (e) Perform an analysis of the allocation bases by selecting agencies with significant Federal awards to determine if the percentage of costs allocated to these agencies has increased from the prior year. For those selected agencies with significant allocation percentage increases, ascertain if the data included in the bases are current and accurate.  (f) Verify that carry-forward adjustments are properly computed in accordance with 2 CFR Part 200, Appendix V, paragraph G.3.  (3) *Testing of the State/Local Government-Wide Central Service CAPs – Billed Section II Costs*  (a) For billed central service activities accounted for in separate funds (e.g., internal service funds), ascertain if:  (i) Retained earnings/fund balances (including reserves) are computed in accordance with the cost principles;  (ii) Working capital reserves are not excessive in amount (generally not greater than 60 calendar days for cash expenses for normal operations incurred for the period exclusive of depreciation, capital costs, and debt principal costs); and  (iii) Adjustments were made when there is a difference between the revenue generated by each billed service and the actual allowable costs.  (b) Test to ensure that all users of services are billed in a consistent manner. For example, examine selected billings to determine if all users (including users outside the governmental unit) are charged the same rate for the same service.  (c) Test that billing rates exclude unallowable costs, in accordance with the cost principles and Federal statutes.  (d) Test, where billed central service activities are funded through general revenue appropriations, that the billing rates (or charges) were developed based on actual costs and were adjusted to eliminate profits.  (e) For self-insurance and pension funds, ascertain if the fund contributions are appropriate for such activities as indicated in the current actuarial report.  (f) Determine if refunds were made to the Federal Government for its share of funds transferred from the self-insurance reserve to other accounts, including imputed or earned interest from the date of the transfer.  *Auditors must include results of this testing in the Section B - Audit Implications Summary of the FACCR.* |